

rules and regulations thereunder applicable to a national securities exchange<sup>4</sup> and, in particular, the requirements of section 6(b) of the Act<sup>5</sup> and the rules and regulations thereunder. Specifically, the Commission finds that the proposal is consistent with section 6(b)(5) of the Act,<sup>6</sup> in that the proposal is designed to promote just and equitable principles of trade, remove impediments and perfect the mechanisms of a free and open market, and to protect investors and the public interest.

The Commission considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an "obvious error" may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an "obvious error" has occurred and the process for reviewing such a determination should be based on specific and objective criteria and subject to specific and objective procedures.

The Commission believes that the Exchange's proposal to revise Rule 24.16 by modifying the manner in which the Rule applies its obvious price error provision to transactions in index options, options on ETFs, and options on HOLDRS that occur as part of the HOSS process during regular opening rotations and during opening rotations on the final settlement day for volatility indexes is appropriate. The proposal provides for an objective standard because in each of the foregoing situations, the fair market value calculation must take into account the size of the quote.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>7</sup> that the proposed rule change (SR-CBOE-2007-122), as amended, is hereby approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>8</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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<sup>4</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>5</sup> 15 U.S.C. 78f(b).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>7</sup> 15 U.S.C. 78s(b)(2).

<sup>8</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57283; File No. SR-DTC-2007-11]

### Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing of Amendment No. 1 to Proposed Rule Change To Amend Its Operational Arrangements as It Applies to Structured Securities

February 6, 2008.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder<sup>2</sup> notice is hereby given that on September 7, 2007, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change. The proposed rule change was published for comment in the **Federal Register** on November 26, 2007.<sup>3</sup> The Commission received four comments on the original proposal.<sup>4</sup> On December 14, 2007, DTC filed Amendment No. 1 to the proposed rule change.<sup>5</sup> The filing, as amended, is described in Items I, II, and III below, which items have been prepared primarily by DTC. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested parties.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change seeks approval to amend DTC's "Operational Arrangements Necessary for an Issue to Become and Remain Eligible for DTC Services" ("Operational Arrangements") as it applies to Structured Securities. DTC's Operational Arrangements is a contractual agreement between DTC, issuers, and paying agents that outlines the procedural and operational

requirements for an issue to become and remain DTC eligible.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, DTC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. DTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>6</sup>

##### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The proposed rule change seeks to amend DTC's Operational Arrangements as it applies to Structured Securities in order to: extend the deadline by which paying agents of such securities must submit periodic payment rate information to DTC; establish an exception processing fee applied to certain Structured Securities whose features prevent paying agents from complying with the extended deadline; and provide that DTC track and make publicly available reports on paying agent performance as it relates to timeliness and accuracy of Structured Securities payment rate information submitted to DTC.

##### 1. Background

On September 7, 2007, DTC filed with the Commission proposed rule change DTC-2007-11. Amendment No. 1 removes reference to the imposition of a processing fee on January 1, 2008, and corrects the identity of the party that will identify an issue as conforming or non-conforming and will submit a written attestation giving the reason for non-conformance.

A Structured Security, such as a collateralized mortgage obligation or asset-backed security ("ABS"), is a bond backed by a pool of underlying financial assets. The underlying assets generally consist of receivables such as mortgages, credit card receivables, or student or other bank loans for which the timing of principal payments by the underlying obligors may be variable and unpredictable. A Structured Security may also incorporate credit enhancements or other rights that affect

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 34-56795 (November 15, 2007), 72 FR 66009.

<sup>4</sup> Simon Griffiths, Vice President, JP Morgan (December 10, 2007); Tom Migneron, Principal, Edward Jones (December 11, 2007); Dan W. Schneider, Baker & McKenzie LLP, Counsel to the Association of Global Custodians, Chicago, Illinois (December 12, 2007); Norman Eaker, Chairman, Securities Industry and Financial Markets Association, Operations Committee, Gussie Tate, President, Securities Industry and Financial Markets Association, Dividend Division, and Thomas Hamilton, Vice Chairman, Securities Industry and Financial Markets Association, MBS and Securitized Products Division Executive Committee (December 19, 2007).

<sup>5</sup> Amendment No. 1 replaces and supersedes the original filing in its entirety. Amendment No. 1 corrects an inadvertent reference to "issuer" instead of "underwriter" in Section 2(ii).

<sup>6</sup> The Commission has modified the text of the summaries prepared by DTC.

the amount and timing of payments to investors.

Communication of periodic payment rates of principal and interest ("P&I") to the end investors in Structured Securities depends on application of stringent time frames for information reporting and significant interdependencies among servicers of the underlying assets, specifically trustees, custodians, paying agents on the securities, DTC, and the financial intermediaries that act on behalf of the investors. Given the complexity of structure and calculations of cash flow from the underlying assets through the issuer to the end investor and the interdependencies on timeliness and accuracy of performance throughout the chain of servicers and intermediaries, timely and accurate submission of payment rate information on Structured Securities may be difficult to achieve. As a result, payment rates typically are announced late on a significant number of issues, and the number of post-payable adjustments made to correct inaccurate payments resulting from inaccurate payment rate information is higher than for any other security type. Furthermore, the volume of P&I payments for Structured Securities processed through DTC has grown rapidly in recent years and currently represents approximately 25% of all P&I payments processed through DTC. Incorrect and late payment rate reporting causes increased operations processing costs, inefficient cash management, and loss of income.

Accordingly, DTC formed a cross-industry working group to study the severity of the problem of processing Structured Securities P&I and to analyze possible solutions.<sup>7</sup> In its analysis, the working group studied the payment rate reporting history of various Structured Securities, noting factors such as paying agent and type of deal structure. The working group determined that extending the date by which paying agents must submit rate information to DTC would allow a greater number of Structured Securities to meet DTC's requirements and thus be eligible for DTC services. It also concluded that there is a significant subset of Structured Securities for which the paying agent may not be able to comply even with an extended time frame for delivery of payment rate information because of features inherent in the structure of the security issue. It determined these securities should be

expressly identified and handled as issues that require exception processing. Finally, it concluded that paying agent rate reporting performance on all Structured Securities should be evaluated and made publicly available to participants and other relevant parties. Accordingly, DTC proposes to implement the changes set forth below.

## 2. Proposed Amendments to Operational Arrangements

DTC's Operational Arrangements governs issue eligibility for deposit at DTC and issuer and agent obligations regarding servicing of the issue thereafter. Regarding notification on issues that pay P&I periodically or that pay interest at a variable rate, the Operational Arrangements currently requires the paying agent on the security to provide payment rate information to DTC preferably five business days but no later than two business days prior to the payable date.

### (i) Extending the Deadline for Reporting on Payment Detail

Currently, the majority of Structured Securities have features that prevent paying agents from being able to adhere to the current Operational Arrangements rate reporting deadline. DTC is proposing to amend the Operational Arrangements to require that the payment notification regarding Structured Securities be provided to DTC by the paying agent preferably five business days but no later than one business day prior to the payable date. In addition, DTC will extend its current processing deadline for receipt of payment rate files from 7 p.m. to 11:30 p.m. The extended deadlines should allow paying agents to provide rates in a timely and accurate fashion for a majority of Structured Securities issues and should permit the securities to remain eligible for DTC's services while still providing DTC with adequate time to process the information and make timely payments to its participants.

### (ii) Securities Classifications

Due to the complexity of certain Structured Securities, it is anticipated that the paying agents for certain issues will still not be able to meet the amended Operational Arrangements requirements for timely payment rate reporting even with the extended reporting period.<sup>8</sup> Therefore, DTC

<sup>8</sup> Although approximately 15% of Structured Security issues currently fail to have rates submitted to DTC in a timely manner, it is estimated that approximately only half of these have structural impediments to meeting the new requirements. Failures in timely rate reporting in other instances are believed to be curable by improved servicing and reporting on the securities.

proposes to distinguish between "conforming" and "non-conforming" Structured Securities. Non-conforming Structured Securities will be issues for which the underwriter and paying agent have concluded that the security has features that will likely preclude the paying agent from submitting rate information to DTC in conformity with the requirements of the Operational Arrangements. The conforming/non-conforming identification will be made at the time the security is made eligible at DTC. For each Structured Securities underwriting that the underwriter and paying agent identify as non-conforming, the underwriter and paying agent shall submit a written attestation giving the reason for non-conformance. DTC will in turn identify non-conforming Structured Securities to participants and other relevant parties and will add an indicator to the appropriate DTC systems functions to denote non-conforming securities. Paying agents also shall be required to evaluate their entire portfolio of Structured Securities that have previously been made eligible and are currently on deposit at DTC to identify non-conforming securities.

### (iii) Exception Processing Fee Applicable to Non-Conforming Securities

Securities processing inefficiencies and rate inaccuracies associated with late payment rate reporting lead to increased costs. In order to recoup the increased processing costs, DTC is proposing to impose an exception processing fee to the managing underwriter of the non-conforming issue at the time of underwriting. No fee will be charged retroactively on issues already on deposit at DTC prior to the implementation of the fee.

The exception processing fee of \$4,200 per CUSIP was calculated based upon anticipated excess costs of P&I processing for non-conforming Structured Securities. The fee was filed with the SEC as part of DTC's annual establishment of fees.<sup>9</sup>

The aggregate net amount of the exception processing fees will be allocated and rebated on a pro rata basis annually to the DTC participants for whom DTC processed Structured Securities P&I allocations. For each participant, DTC would compare the participant's total number of allocations to the total number of all participants' allocations, and the resulting percentage would be applied against the total exception processing fund with the

<sup>7</sup> The group consisted of representatives from the Securities Industry and Financial Markets Association (SIFMA), major paying agents, servicers and master servicers, underwriters, and major retail and institutional broker-dealers and custodians.

<sup>9</sup> Securities Exchange Act Release No. 34-57193 (January 24, 2008), 73 FR 5614.

resulting amount being rebated to the participant. The total exception processing fund would be calculated as the sum of all exception processing fees less DTC's cost to administer the program.

(iv) Evaluation and Publication of Paying Agent Performance

DTC is proposing to track and evaluate paying agent performance with regard to timeliness and accuracy of payment rate reporting on Structured Securities and to make these evaluations available to DTC participants and to the public. The purpose of these evaluations is to identify poor payment and reporting performance for which a paying agent should be able, based on its attestation, to correct any underlying servicing issues associated with the payment and information flows.

DTC plans to expand evaluation reports ("Report Cards") that are currently used to compare rate submission performance and accuracy of Structured Securities paying agents. Currently the Report Cards are only distributed among the paying agents being compared. DTC is proposing to make the Report Cards available on its Web site. The Report Card tracks and reports performance for a given month by paying agent with respect to the number of collateralized mortgage obligations and asset-backed securities announcements processed, the number of late and amended announcements, the payment dollars, late payment dollars, and the number of payments and late payments. Timeliness of payment rate notification on non-conforming Structured Securities will not be included in the proposed paying agent performance evaluation based on the paying agent's attestation that the Structured Security is a non-conforming issue. The other factors will be included with respect to both conforming and non-conforming securities.

(v) Conclusion

In summary, altering the Operational Arrangements to allow paying agents additional time in which to report payment rates will allow more issues of Structured Securities to be eligible at DTC. Identification of issues that cannot meet the proposed extended reporting deadlines and reporting on paying agent performance will allow the industry to anticipate processing inefficiencies associated with certain Structured Securities issues. Furthermore, imposition of an exception processing fee on Structured Securities that cannot meet the extended reporting deadlines due to deal structure will shift the expense associated with these securities

to the underwriters and issuers that create the structure.

DTC believes that the proposed rule change is consistent with the requirements of section 17A of the Act<sup>10</sup> and the rules and regulations thereunder because the proposed changes removes impediments to and perfects the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.

*(B) Self-Regulatory Organization's Statement on Burden on Competition*

DTC does not believe that the proposed rule change will have any impact or impose any burden on competition.

*(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

The Commission received four written comment letters to the original proposed rule change, which was published for comment in the **Federal Register** on November 26, 2007.<sup>11</sup> These comments to the proposed rule change and any received to its amended version will be summarized and responded to in a future Commission release.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within thirty-five days of the date of publication of this notice in the **Federal Register** or within such longer period:

(i) As the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

*Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>) or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-DTC-2007-11 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-DTC-2007-11. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filings also will be available for inspection and copying at the principal office of DTC and on DTC's Web site at: [http://www.dtcc.com/downloads/legal/rule\\_filings/2007/dtc/2007-11-amendment.pdf](http://www.dtcc.com/downloads/legal/rule_filings/2007/dtc/2007-11-amendment.pdf). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-DTC-2007-11 and should be submitted on or before February 28, 2008.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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<sup>10</sup> 15 U.S.C. 78q-1.

<sup>11</sup> *Supra*, note 3.

<sup>12</sup> 17 CFR 200.30-3(a)(12).